

J. EMPLOYMENT TAXES

1. Introduction

This topic will focus on employment tax provisions that apply to exempt organizations. Included is also a discussion of the processing of ministerial exemptions from self-employment taxes with regard to whether the ordaining organization is described in IRC 501(c)(3) and 170(b)(1)(A)(i).

2. Federal Insurance Contributions Act (FICA)

The Federal Insurance Contributions Act was enacted by Congress to ensure a degree of security for workers and their dependents through old age pensions, disability benefits, survivors benefits, and hospital insurance. These benefits are funded through FICA withholding from wages of employees and matching contributions of employers.

Public Law 98-21, The Social Security Act of 1983, provided for sweeping changes affecting exempt organizations. Prior to the enactment of the 1983 amendments, IRC 3121(b)(8)(B) provided for the exclusion from social security coverage of work performed for organizations described in IRC 501(c)(3). The organization could affirmatively waive its exemption by filing Form SS-15, Certificate Electing Social Security Coverage Under the Federal Insurance Contributions Act, or could constructively waive its exemption by paying FICA taxes during any period that included at least three consecutive calendar quarters after 1972. (See IRC 3121(k).) Under the new law, social security coverage is extended on a mandatory basis, with certain exceptions, to employees of all exempt organizations, including IRC 501(c)(3)'s, effective January 1, 1984.

3. Exceptions That May Be Applicable to Certain Employees of Exempt Organizations

While Public Law 98-21 repealed the special rules relating specifically to organizations described in IRC 501(c)(3), the new law was not extended to all employees of or all wages paid by exempt organizations. The exceptions that existed prior to the enactment of Public Law 98-21 and remain as follows:

IRC 3121(a)(16) provides that remuneration paid by an organization exempt from income tax under IRC 501(a) or under IRC

521 shall not include "wages" paid by the organization to the employee if the remuneration paid in any calendar year for services is less than \$100. IRC 3121(b)(2) provides that the term "employment" shall not include domestic service performed in a local college club, or local chapter of a college fraternity or sorority, by a student who is enrolled and is regularly attending classes at a school, college, or university.

IRC 3121(b)(7) provides that service performed in the employ of a State, or any political subdivision thereof, or an instrumentality of any one or more of the foregoing which is wholly owned thereby, with certain exceptions, is excluded from the term "employment".

IRC 3121(b)(8)(A) provides that "employment" does not include service performed by a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry or by a member of a religious order in the exercise of duties required by such order provided a certificate of election was not filed as described in IRC 3121(r). IRC 3121(r) provides for the election of coverage by filing Form 2031, Waiver Certificate for Use by Ministers, Certain Members of Religious Orders, and Christian Science Practitioners.

IRC 3121(b)(10) provides that the term "employment" shall not include (a) service performed in the employ of a school, college, or university, or (b) service performed in the employ of an organization described in IRC 509(a)(3), with certain exceptions, if the organization is organized, and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of a school, college or university and is operated, supervised, or controlled by or in connection with such school, college or university, if such service is performed by a student who is enrolled and regularly attending classes at such school, college or university.

IRC 3121(b)(12) provides, under certain conditions, that service performed in the employ of an instrumentality wholly-owned by a foreign government is not "employment." IRC 3121(b)(13) provides that the term "employment" does not include service performed as a student nurse in the employ of a hospital or a nurses' training school by an individual who is enrolled and is regularly attending classes in a nurses' training school chartered or approved pursuant to a State law.

The issue of whether or not an organization's employees fall within one of the provisions of IRC 3121(b) is not an issue to be considered by the Exempt Organizations function. That section of the Code falls within the jurisdiction of the Office of Chief Counsel, Individual Income Tax Division, and specific requests for rulings under those provisions should be issued by that office. However, the Exempt Organizations function advises organizations in their ruling or determination letter recognizing them as exempt under IRC 501(a) that, unless specifically excepted, effective January 1, 1984, they are liable for social security taxes if the amount of remuneration paid is at least \$100 during any calendar year. The Exempt Organizations function also advises an organization that may possibly be a wholly owned instrumentality of a State or any political subdivision thereof, e.g., a municipal hospital, or public library, of the provisions of IRC 3121(b)(7), and the procedures to follow for a ruling that it is an instrumentality if such a ruling is desired. If an organization has a dual status as both a IRC 501(c)(3) organization and a wholly-owned instrumentality, the governmental status is controlling for FICA purposes. Thus, the entity would be exempt from the FICA taxes by IRC 3121(b)(7). (See Rev. Rul. 55-386, 1955-1 C.B. 119, as clarified by Rev. Rul. 60-384, 1960-2 C.B. 172.)

Organizations that wish to request a ruling or information relating to IRC 3121 exceptions or matters relating to instrumentalities should address their requests to the Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC 20224. Requests for rulings or information under the jurisdiction of Chief Counsel should be filed in accordance with Rev. Proc. 83-1, 1983-1 C.B. 545.

4. Notification to IRC 501(c)(3) Organizations of Liability for FICA Taxes

Notice 676 (9-83) was mailed by the IRS service centers to all IRC 501(c)(3) organizations listed on the Exempt Organizations Master File as of February 1983. The notice advised those organizations of the new requirements under the social security amendments, and their withholding responsibility for the FICA taxes.

Beginning with the first quarter of 1984, IRC 501(c)(3) organizations will be required under Public Law 98-21 to report covered wages paid to their employees. The amount of wages reported for the first quarter should be for services performed after January 1, 1984, and must be reported by filing Form 941, Employer's Quarterly Federal Tax Return. Organizations may obtain guidance with

respect to the filing of the Form 941 by requesting Publication 15 (Circular E) from any Internal Revenue Service office.

5. Federal Unemployment Tax Act (FUTA)

The Federal Unemployment Tax Act was enacted by Congress to encourage state governments to provide compensation benefits to unemployed workers. The purpose of the taxes under this Act is to finance the cost of administering the state programs. The payment of unemployment benefits is provided under the state unemployment insurance laws. IRC 3301 imposes the FUTA tax on employers to provide unemployment benefits for their employees. The FUTA tax is strictly an employer tax and there are no deductions for this tax from the employee's wages.

IRC 3306(a) provides that the term "employer" includes any person who paid wages of \$1,500 or more during any calendar quarter of the current or preceding calendar year or any person who employed at any time one or more employees for some part of a day in any 20 calendar weeks within the current or preceding year.

IRC 3306(c) provides that, for purposes of determining the liability for taxes under the FUTA provisions, the term "employment" shall include services performed in the employ of any organization exempt from income tax under IRC 501(a) (except IRC 501(c)(3)) or IRC 521, with certain exceptions, if the remuneration for such service is \$50 or more during a calendar quarter.

IRC sections 3306(c)(1) through (c)(20) provide for the exclusion of certain types of employment from the FUTA coverage. The exceptions under the FUTA provisions are somewhat parallel to the exceptions contained in IRC 3121 relating to social security coverage. However, unlike the FICA provisions, IRC 3306(c)(8) provides that services performed in the employ of a religious, charitable, educational, or other organization described in IRC 501(c)(3) which is exempt from income tax under IRC 501(a) are not subject to the FUTA coverage. Employees of generally all other IRC 501(a) or IRC 521 organizations are covered under the Act.

The FUTA tax provisions are administered by the Office of Chief Counsel, Individual Income Tax Division. However, in the ruling or determination letter issued by the Exempt Organizations function, the organizations seeking recognition of exemption are advised that, unless specifically excepted, they may

be liable for tax under the Federal Unemployment Tax Act for each employee who earns \$50 or more during a calendar quarter.

Exempt organizations that are liable for taxes under the FUTA provisions are required to file Form 940, Employer's Annual Federal Unemployment Tax Return, with the appropriate IRS service center. Questions relating to the filing of the return or other matters should be addressed to the local IRC office.

6. Ministerial Exemption from Self-Employment Taxes

Prior to the enactment of Public Law 90-248, dated January 2, 1968, members of religious orders, and Christian Science Practitioners were automatically exempt from self-employment taxes.

For tax years after 1967, IRC 1402(e)(1) provides for the exemption from self-employment taxes with respect to services performed by ministers, members of religious orders, and Christian Science Practitioners. Exemption is requested by the minister by filing an application, Form 4361, Application for Exemption from Self-Employment Tax for Use by Ministers, Members of Religious Orders and Christian Science Practitioners, and stating that for reason of either conscience or religious principles he/she is opposed to the coverage of his/her ministerial services. An exemption cannot be granted if the individual previously filed a certificate of waiver, Form 2031, Waiver Certificate for Use by Ministers, Certain Members of Religious Orders, and Christian Science Practitioners, electing to be covered by self-employment tax.

Form 4361 is filed with the individual's IRS service center. The service center determines whether, (1) the application was timely filed under IRC 1402(e)(2), (2) the application is complete, (3) the ordaining organization is described in IRC 501(c)(3) and IRC 170(b)(1)(A)(i), and (4) the individual previously filed a waiver, Form 2031.

The Exempt Organizations function of the Service becomes involved with regard to (3) above. Rev. Rul. 76-415, 1976-2 C.B. 255 provides that for the purpose of filing Form 4361, an ordained, commissioned or licensed minister of a church is eligible to exercise the election contained in IRC 1402(e) only if the minister is able to establish that the church qualifies as an organization exempt from income tax under IRC 501(c)(3). This revenue ruling was clarified by Rev. Rul. 80-59, 1980-1 C.B. 191, which provides that not only must the minister

establish that the church is a religious organization described in IRC 501(c)(3), but it must also establish that the church is described in IRC 170(b)(1)(A)(i).

Where the individual has satisfied the other requirements, but the service center cannot determine from its records that the ordaining organization is described in IRC 501(c)(3) and IRC 170(b)(1)(A)(i), the service center sends to the individual Form Letter 1786 along with Form 8123, Questions Regarding Status As A Church. This advises the individual that in order to establish the qualification of the ordaining organization it must file an exemption application, Form 1023, with its key District Director or, in the alternative, the individual may submit the information requested on Form 8123 to the Exempt Organizations Technical Division in the National Office.

If the individual elects the second alternative, the Exempt Organizations Technical Division will rule, solely for the purpose of the application under IRC 1402(e), on whether the ordaining organization is or is not the type of organization described in IRC 501(c)(3) and IRC 170(b)(1)(A)(i). If the indication is that the ruling will be adverse, the individual will be offered a National Office conference prior to issuance of the ruling. No further administrative appeal will be afforded unless the individual pays any tax that may be due and files a claim for refund.

Based on the ruling issued by the National Office, the service center will complete the processing of the Form 4361. Issuance of this ruling does not relieve the ordaining organization from applying for recognition of exemption, if such recognition is desired, nor can the ordaining organization rely on the ruling for any purposes.